Economic Monitor

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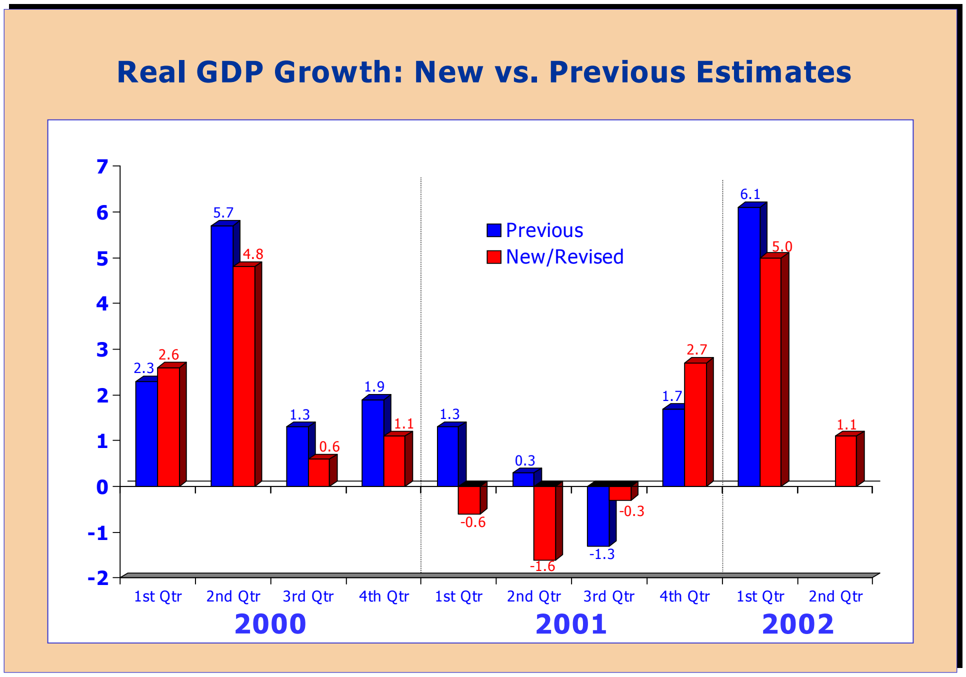
What the New Economic Figures Mean

A REVIEW OF THE COMMERCE DEPARTMENT'S LATEST ESTIMATES, AND THEIR POLICY IMPLICATIONS

New and revised estimates of economic growth from the Department of Commerce show that both the slowdown that began in the second half of 2000 and the recession that began in March 2001 were more pronounced than prior estimates had shown. The new estimates also show that personal income and corporate profits were lower during that period. Nonetheless, the new data continue to show that the economy, aided by the tax cuts enacted last year, is rebounding from the recession and the economic shock from September 11.



The revisions are historical in nature – reflecting past economic performance. Even so, they can clarify the context of policies already enacted, and may help to explain some recent developments, such as unexpected budget results. The new estimates also carry an implicit message: that the current recovery is still young, and uncertainty persists; but conditions would be worse had the tax cuts not been enacted.

New and Revised NIPA Data

The new and revised data, from the Commerce Department's Bureau of Economic Analysis, result from the annual revisions of the National Income and Product Accounts [NIPAs], which typically occur each July. The data, reflected in the chart above, include new estimates for the second quarter of this year, as well as revised estimates for the past several years (from the first quarter of 1999 through the first quarter of 2002).

New estimates for the second quarter of this year show that real gross domestic product [GDP] growth slowed to a 1.1-percent annual rate from the revised 5.0-percent rate of the first quarter. Growth was slower than the 2½-percent rate expected by private forecasters. Much of the slowdown in growth resulted from a dramatic surge in imports – the largest increase since early 1984, when the economy was

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recovering from the recession of the early 1980s. The second quarter data also showed an increase in real investment spending for equipment and software – the first increase in nearly 2 years.

Revised historical estimates show that real GDP growth plunged in the second half of 2000 and by more than previously estimated; real growth slowed to a rate of less than 1 percent at an annual rate over the last 6 months of that year. The slowdown of 2000 led to the decline in real GDP at the beginning of 2001 that greeted the new administration and the 107th Congress. Also, the new data show that the downturn in real GDP from the recession in 2001 started earlier and lasted longer. All told, real GDP declined by 0.6 percent during the recession, a relatively mild decline compared to the average decline of about 2¼ percent for post-World War II recessions.

In addition to the lower estimates of real GDP growth, the revised data showed significantly lower estimates of national income and key income components. As the accompanying table shows, these components – wages and salaries and corporate profits – were lower both in terms of the nominal dollar level and in terms of their share of nominal GDP. The wages and salaries and corporate profits income components are key measures for estimating Federal tax receipts.

The revisions to GDP and income have not come completely as a surprise. As discussed in the July *Economic Update* (Volume 1, Number 3, 11 July 2002): "[T]he revised data may also show the recession – in terms of the decline in real GDP – was worse than currently estimated, at -0.3 percent. Downward revisions to income and real GDP estimates would help to better explain some recent developments, including the sharp (and currently unexplained) fall in tax receipts and the extent of the increase in the unemployment rate." Looking at the dramatic revision in the GDP and income data, it is not a surprise that the estimate of the current year deficit has increased to the $150 billion range. The GDP and income revisions should not worsen that estimate, though, as tax estimators already had incorporated the underlying data used in making the NIPA revisions.

The Right Policies at the Right Time

The figures confirm, once again, that the tax reduction and stimulus legislation enacted by Congress and the President were well-timed and properly designed to reverse the previous slowdown and support the current recovery. As discussed in an earlier *Economic Monitor* (Volume 1, Number 1, 15 May 2002): "The historically high level of taxation relative to GDP [of the late 1990s], coupled with large and growing structural surpluses, created a 'fiscal drag' on the economy." Tax cuts helped reverse that drag.

Selected Income Measures and Shares in the NIPAs

(Calendar Year and Quarter Data)

	2000	2001	1st Qtr. 2002
Nominal Level ($Billions)			
Wages and Salaries			
Revised	4,836	4,951	4,965
Previous	4,837	5,098	5,156
Corporate Profits Before Tax			
Revised	782	670	639
Previous	845	699	644
Income Shares (% of Nominal GDP)			
Wages and Salaries			
Revised	49.2	49.1	48.1
Previous	49.0	49.9	49.3
Corporate Profits Before Tax			
Revised	8.0	6.6	6.2
Previous	8.6	6.8	6.2

Shortly after taking office, the President formally made his tax cut proposals to Congress, and bipartisan congressional action led to their adoption by early June. As detailed in the May *Economic Monitor,* the personal income tax relief, investment tax incentives, and stimulus policies were the right policies at the right time. The pattern of real GDP growth in the chart on the previous page shows that the tax rebates and income tax cuts kicked in at precisely the time needed (the third quarter of 2001) to help boost the economy out of recession and help the Nation deal with the economic shock of September 11. In the absence of the tax cuts and the subsequent investment tax incentives, the recession would have been worse, and the recovery slower, with greater job losses and higher unemployment, than actually occurred.